Core Principles for Independent Audit Regulators

Introduction

IFIAR is an organization of independent audit regulators (hereinafter, ‘audit regulators’). The organization’s primary aim is to enable its Members to share information regarding the audit market environment and practical experiences of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.

Consistent with the IFIAR Charter, the Core Principles (hereinafter, ‘Principles’) seek to promote effective independent audit oversight globally, thereby contributing to Members’ overriding objective of serving the public interest and enhancing investor protection by improving audit quality.

An audit regulator’s membership in IFIAR is not dependent on its status in implementing the Principles. However, Members are encouraged to work towards implementing them where appropriate in their own jurisdictions, taking account of the risk profile, size and complexity of audit firms in their market. It is recognized that legislative change or other measures by national authorities not in control of the audit regulator may be required to achieve adherence to the Principles.

The Principles are intended to:

- Assist Members in developing their own national arrangements through being able to draw on and hence benefit from the experience of other members;
- Advance widespread adoption of high quality audit oversight practice aimed at fostering high quality audits and promoting public trust in the financial reporting process; and
- Support cooperation between regulators and promote greater consistency of audit oversight.

The Principles may also assist audit regulators who are not already Members of IFIAR to develop effective independent audit oversight arrangements.

The Principles are presented in bold lettering followed by an explanatory text that provides further explanation.

A system of audit oversight and audit regulation can only be effective subject to certain preconditions; that is if it exists within an appropriate external environment. Such preconditions, although often outside the control of the national audit oversight system, in practice have a direct impact on the effectiveness of that system. The main precondition is the existence of a well-developed legal and corporate governance framework as to provide necessary support for high quality auditing. Elements of this framework will cover the following:

- Comprehensive and well defined accounting and auditing principles and standards that are generally accepted;
- Legal requirements for the preparation and publication of financial statements according to those principles and standards;
- An enforcement system for preparers of financial statements to ensure compliance with accounting standards (e.g. fines, shareholder redress or penalties on responsible managers for non-compliance);

- Corporate governance arrangements and practices that support high-quality corporate reporting and auditing practice; and
- Effective educational and training arrangements for accountants and auditors.

Where shortcomings exist, audit regulators should make the government or other relevant decision makers aware of such matters and their potential impact on audit quality or the operation of an effective audit oversight system. Audit regulators should also act, as part of their normal activities, with the aim of mitigating the effects of such shortcomings on the effectiveness of their oversight, regulation and inspection.

Part A. Structure

Principle 1: The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.

Audit regulators should have a mandate to work in the public interest and protect investors by seeking to improve audit quality. The responsibilities and powers of audit regulators should, at a minimum, require independent oversight of the audits of public interest entities.

The legal framework for audit oversight should set forth the audit regulator's mandate and responsibilities, and provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties, including powers to address, through inspection and enforcement, compliance with the requirements for the authorization/registration of auditors/audit firms and compliance with applicable auditing, professional and independence standards.

Principle 2: Audit regulators should be operationally independent.

Independence means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial, or other sectoral interests, in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.

Principle 3: Audit regulators should be transparent and accountable.

The audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility. Further, the decisions and actions of the audit regulator should be subject to appropriate scrutiny and review, including appeal to a higher authority. Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm by firm basis.

Part B. Operations

Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit license and/or registration.

Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities. Audit regulators should have the authority and ability to enforce inspection findings and recommendations. The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's license or registration.

Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties and for then dealing with such information, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or noncompliant execution of an audit.

Principle 5: Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence.

Audit regulators should have arrangements in place to ensure that inspection staff members are independent of the profession. These arrangements will, as a minimum, include ensuring that staff members should not be practicing auditors or employed by or affiliated with an audit firm, and that the arrangements are not controlled in any form by a professional body.

In order for audit regulators to be effective, it is a prerequisite that there is sufficient staff of appropriate competence. The persons carrying out the reviews of quality assurance systems of audit firms should have appropriate professional training and relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews.

This also means that adequate arrangements for consultation and discussion amongst inspectors are in place. New inspectors should be subject to proper supervision and appropriate training.

Principle 6: Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements.

Audit regulators should maintain the highest standards of ethical conduct to provide the public with confidence in the objectivity of their decisions. Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff and ensure that appropriate arrangements are in place to protect confidential information from public dissemination.

Principle 7: Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties.

Taking into account the global nature of the financial markets, where necessary and relevant, cooperation and information sharing with other audit regulators and other third parties, including financial market regulators, is helpful to improve audit quality.

Audit regulators should provide timely assistance to each other within reasonable limits. Arrangements should be in place for sharing information between audit regulators and other regulators (or between parts of the audit oversight system if it involves more than one body), and for protecting the confidentiality of such information.

Part C. Principles for inspections

Principle 8: Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.

The recurring inspections should be conducted pursuant to a process comprising the selection of the audit firms to inspect, appointment of an inspection teams with appropriate expertise and competence, notification to the audit firm, advance documentation request, notification of selection of audit engagements for review, meetings with management, and on-site inspection arrangements. The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.

Principle 9: Audit regulators should ensure that a risk-based inspections program is in place.

Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be commensurate with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.

Principle 10: Audit regulators should ensure that inspections include effective procedures for both firm wide and file reviews.

The risk-based inspection approach should also be reflected in both firm wide and audit file inspection procedures. The firm wide procedures should address the audit firm's quality control system as reflected in the firm's organization, policies and procedures. ISQC 1 or similar standards should be used as a benchmark in performing firm wide procedures. The inspection process should also include adequate testing of selected audit files in order both to determine the effectiveness of the firm's quality control system and to assess compliance with applicable laws, rules and professional standards.

Principle 11: Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm.

Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems and issues related to an audit firm's performance of audits that are identified during an inspection are reported to the audit firm. Audit regulators' reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report. In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.